Revenue

New revenue will help Washington build back stronger from pandemic

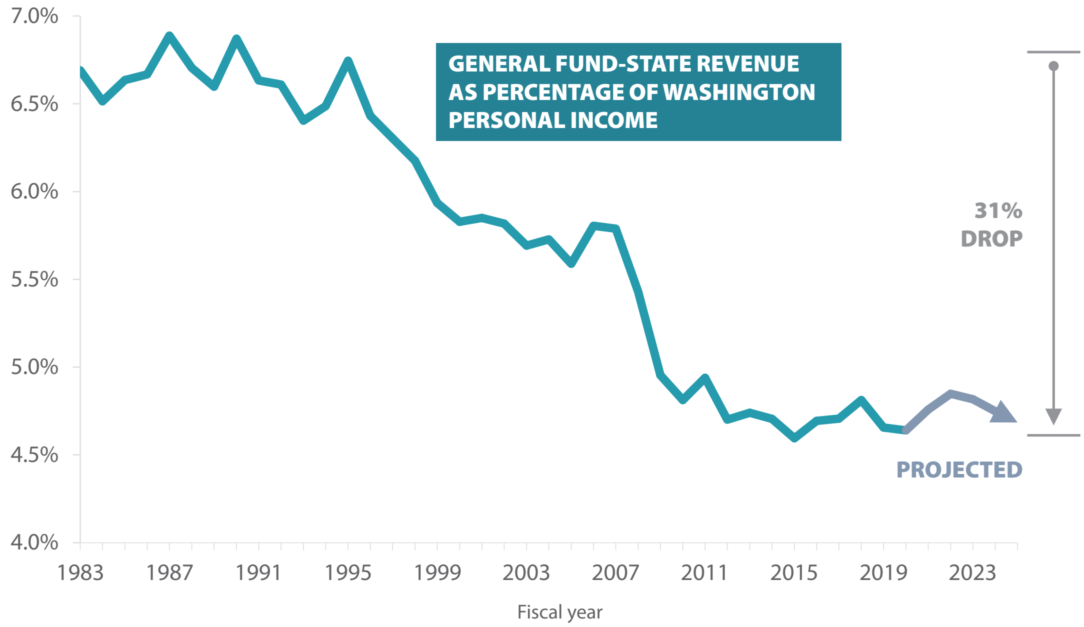
Washington's revenue projections plummeted last spring after the state had to impose broad restrictions to slow the spread of COVID-19. Though the forecast has improved, projected revenue collections through the end of the next biennium remains more than $3.3 billion below where it was before the pandemic hit.

Fortunately, the federal government approved a large relief package to help Washington and other states pay for short-term response efforts. And Washington had healthy reserves in the bank to help close budget shortfalls and address longer-term recovery efforts.

But the federal relief funds have run out, and the state will likely have to use most of its reserves to help balance its next two-year budget.

The governor's 2021–23 operating budget calls for a mix of tax and revenue changes to continue the state's pandemic response and recovery efforts, and help ensure the state is better prepared for future public health crises. New revenue will also help protect previous state investments in vital services and enable the state to maintain healthy reserves.

Over the past 25 years, state revenue collections as a share of the economy have fallen by 31%



Source: Washington State Economic and Revenue Forecast Council, Nov. 2020

Even with the revenue increases the governor is proposing, Washington's tax collections as a share of the economy will remain below the national average and well below where it was 30 years ago. In the early 1990s, General Fund–State revenue collections equaled nearly 7% of the overall economy (as measured by total personal income). But revenue collections as a share of the economy have declined steadily — to less than 5% today — and are projected to keep falling.

Capital gains tax

As he has previously, the governor is calling for a new capital gains tax on the sale of stocks, bonds and other assets. Exemptions are provided for sole proprietor businesses, retirement accounts, homes, farms and forestry. Earned income from salaries and wages is not capital gains and would not be taxed.

Washington is one of just nine states that do not tax capital gains.

The proposal is designed to increase the share of state taxes paid by our state's wealthiest taxpayers. The state would apply a 9% tax to capital gains earnings above $25,000 for individuals and $50,000 for joint filers.

At those earnings thresholds, the tax would primarily affect very wealthy households. In fact, if the tax had been in place in 2018, the average total income of affected households would have been nearly $750,000. And the tax will only affect a tiny fraction of taxpayers — about 1.9% of households in the first year.

The capital gains tax, which wouldn't take effect until the second year of the next biennium, would raise an estimated $1.1 billion in fiscal year 2023 and more than $2.4 billion during the 2023–25 biennium.

The governor supports adding a capital gains tax in Washington in large part because it won't make the state's upside down tax system even more regressive. Under Washington's tax system — the most regressive in the country — the poorest households pay nearly 18% of their income in taxes, compared to just 3% for the very wealthiest households.

Narrowing tax loophole related to "bad debts"

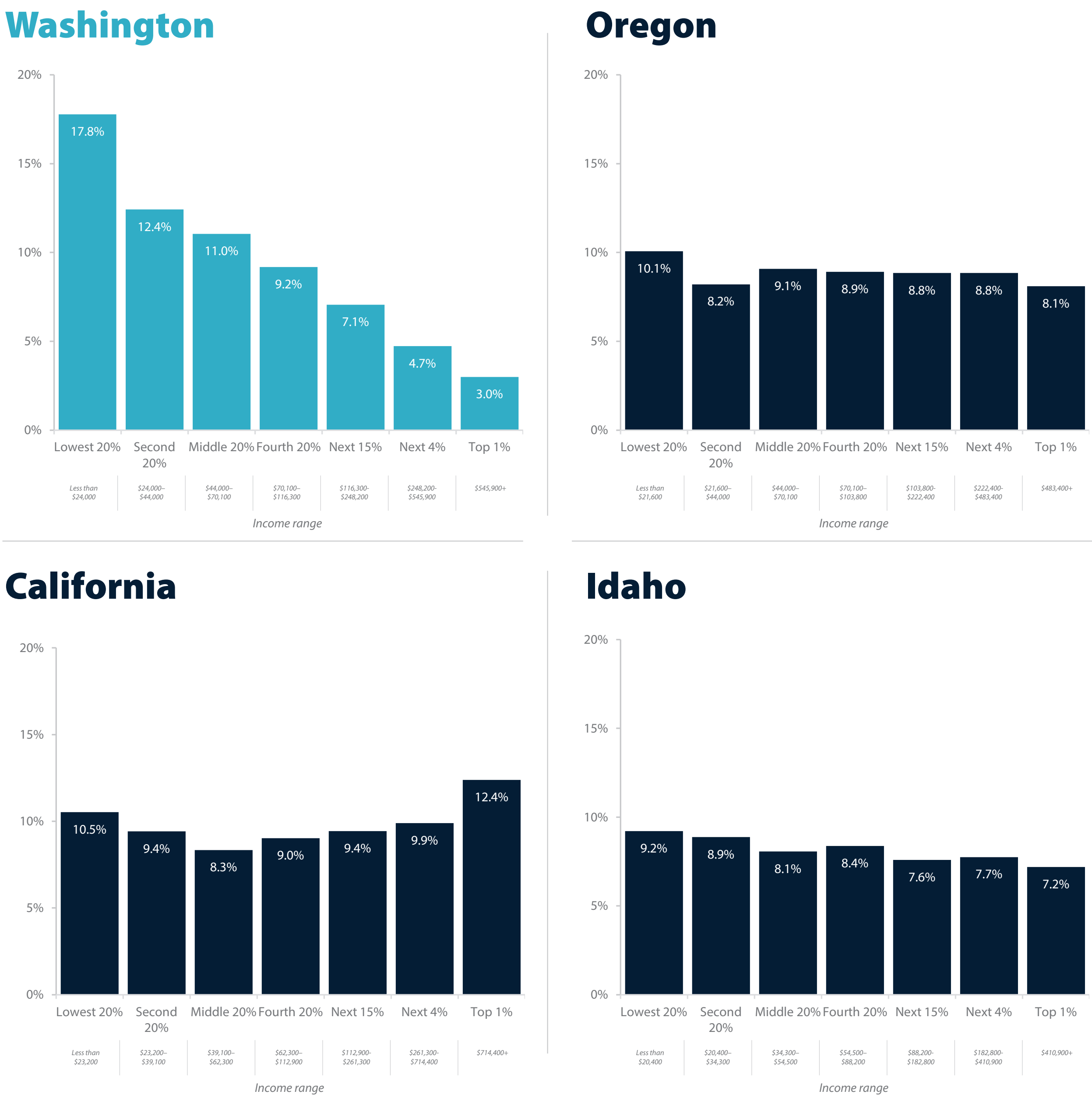
The governor proposes narrowing the scope of the existing bad debt deduction on business and occupation taxes and the bad debt credit/refund on the sales/use tax. Under this change, sellers will only be allowed to claim these tax preferences for bad debts from nonpayment by their own customers. Sellers will no longer be able to claim these tax preferences for reimbursement of losses sustained by third-party creditors of their customers. Narrowing these tax preferences will generate about $36.2 million for the state General Fund during the 2021–23 biennium.

Covered lives assessment

The governor's budget calls for major new and ongoing investments in foundational public health services. To fund those new investments, the governor proposes a new "covered lives assessment." For each person covered, the state will assess a charge on health insurers, Medicaid managed care organizations, limited health services contractors and third-party administrators. The per member, per month fee will be set and adjusted to bring in $205 million in fiscal year 2023 and about $343 million in the 2023–25 biennium. The state Office of the Insurance Commissioner will determine and collect the assessment.

Washington has the most regressive state and local tax system in the nation

State and local taxes as a share of family income for non-elderly taxpayers



Source: Institute on Taxation and Economic Policy, 2018 "Who Pays?" report.